EUROPEAN CENTRAL BANK

EUROSYSTEM

Non-banks in the EU: transition to CMU and macroprudential perspective

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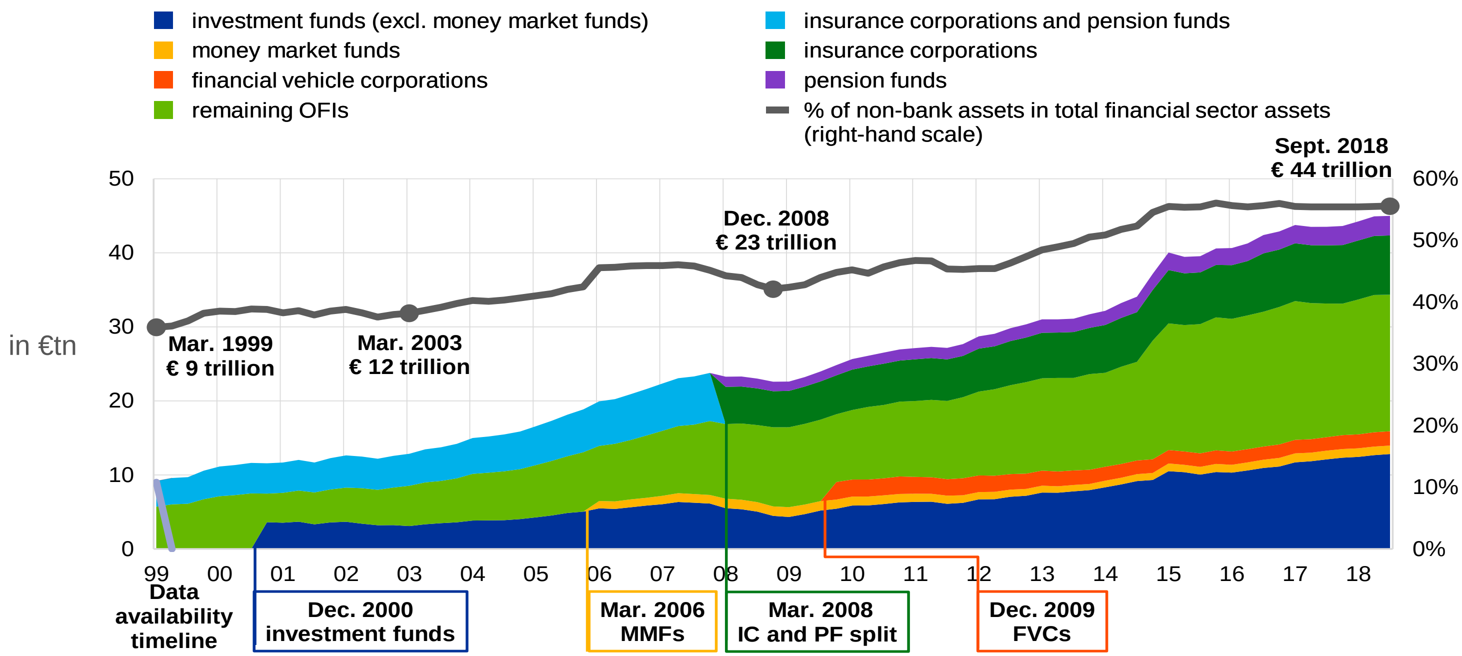
Overview

Growing non-bank financial sector in the Euro Area

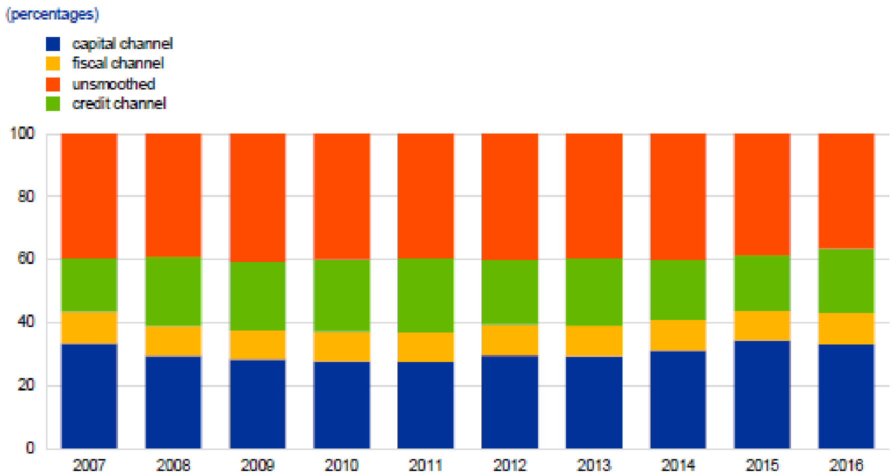


- The structure of the EU financial sector is changing

Potential role in shock absorption

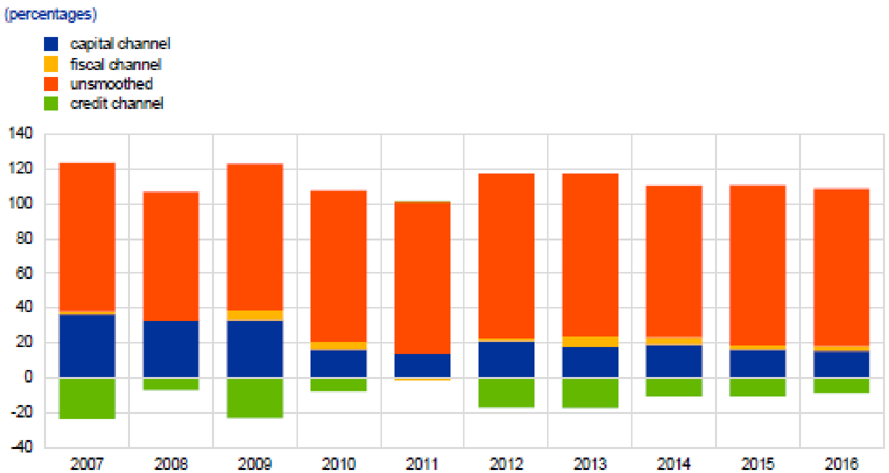
- In US, 60% of the shocks to GDP are smoothed; in EA only 20%
- Risk sharing takes place mainly via private channels, with capital market channel explaining largest share of overall inter-state smoothening of shocks
- Credit channel accounts for app. 20% of risk sharing in the US; in EA its contribution is negative

Consumption risk sharing in the Unites States and its channels



Source: ECB calculations.

Consumption risk sharing in the euro area and its channels

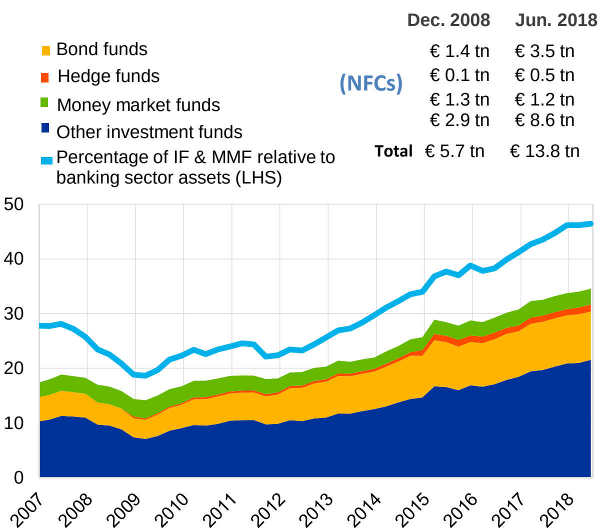


Source: ECB calculations.

…in supporting the financing of the real economy

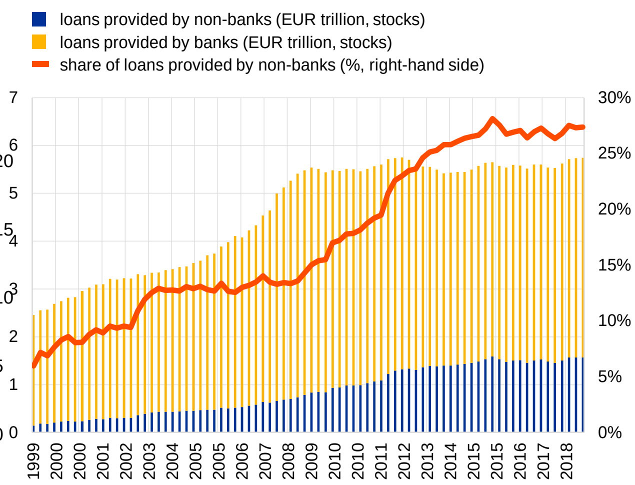
Total assets of euro area investment funds

Q1 2007-Q2 2018, percentages, €tn



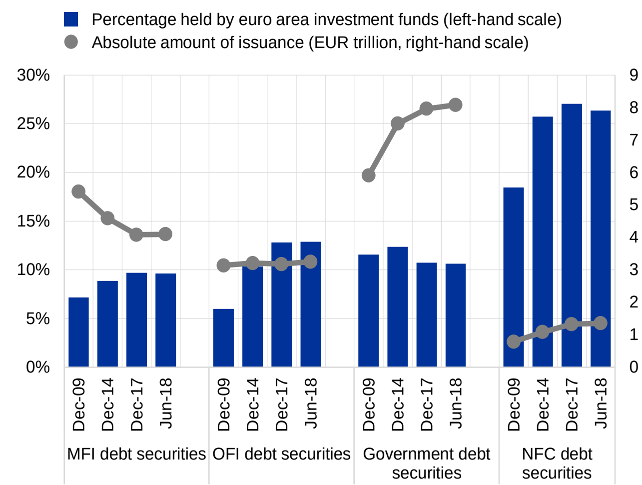
Loans provided to NFCs

1999 -2018, €tn



Euro area investment funds' holdings of euro area debt securities

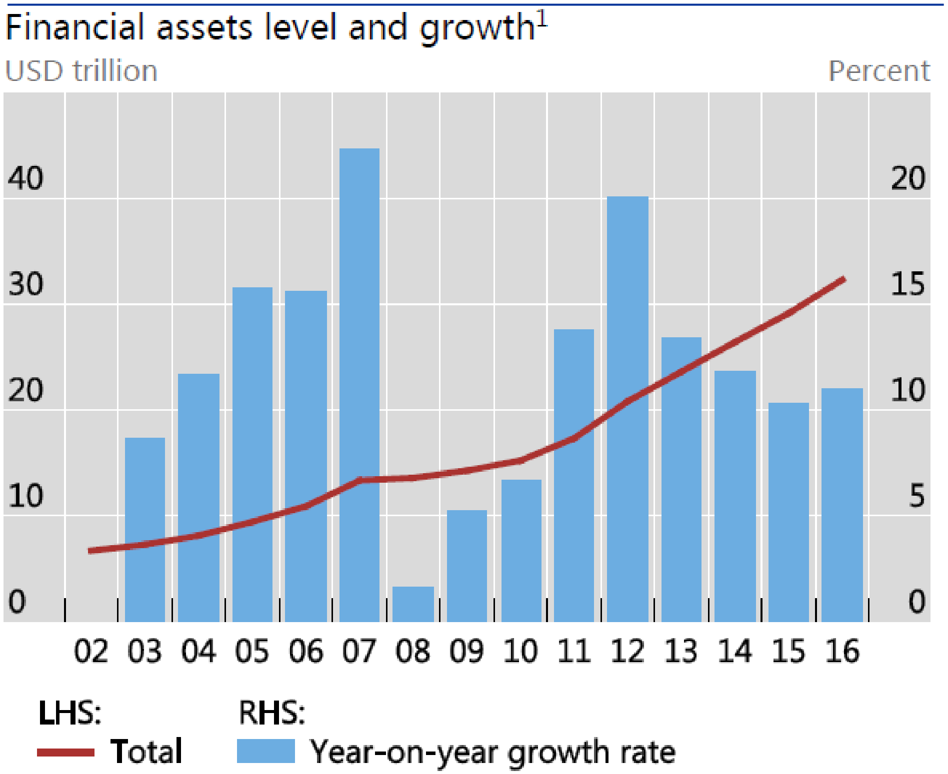
in €tn



IFs offering daily redemptions can be subject to run risk, in particular if they invest in illiquid assets

Developments for run-sensitive investment funds

2002 -2016, Dollar tn

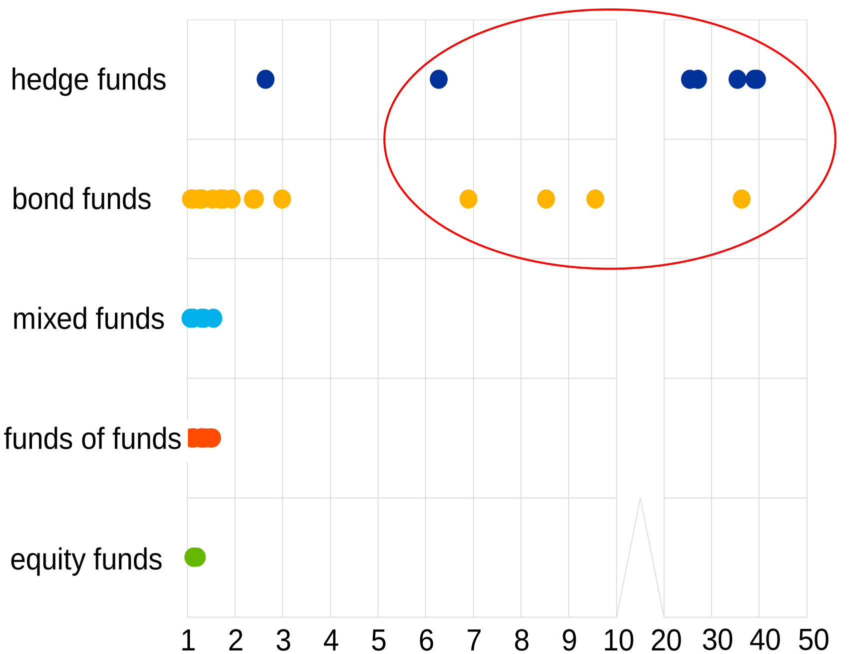


Source: FSB (2018). **Notes:** Economic Function 1 (EF1) relates to collective investment vehicles (CIVs) with features that make them susceptible to runs.

3. Evolving financial stability vulnerabilities in IF sector

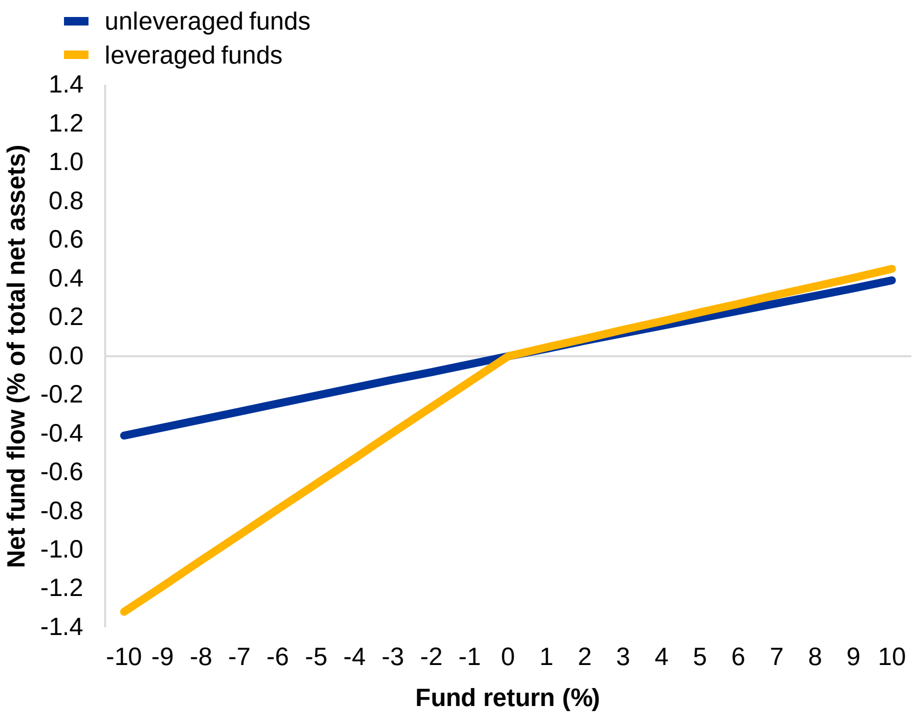
Leverage … is low on average, but with few relevant outliers, and may increase procyclical behaviour among investors

Example: Leverage among Dutch AIFs
(average quarterly values in 2016; y-axis: net exposure/net asset value)



Sources: DNB, and DNB and ECB calculations.
Notes: Data on net exposure and fund's net asset value from the AIFMD reporting framework. Substantial leverage is defined under the AIFMD as net exposure exceeding three times a fund's net asset value.

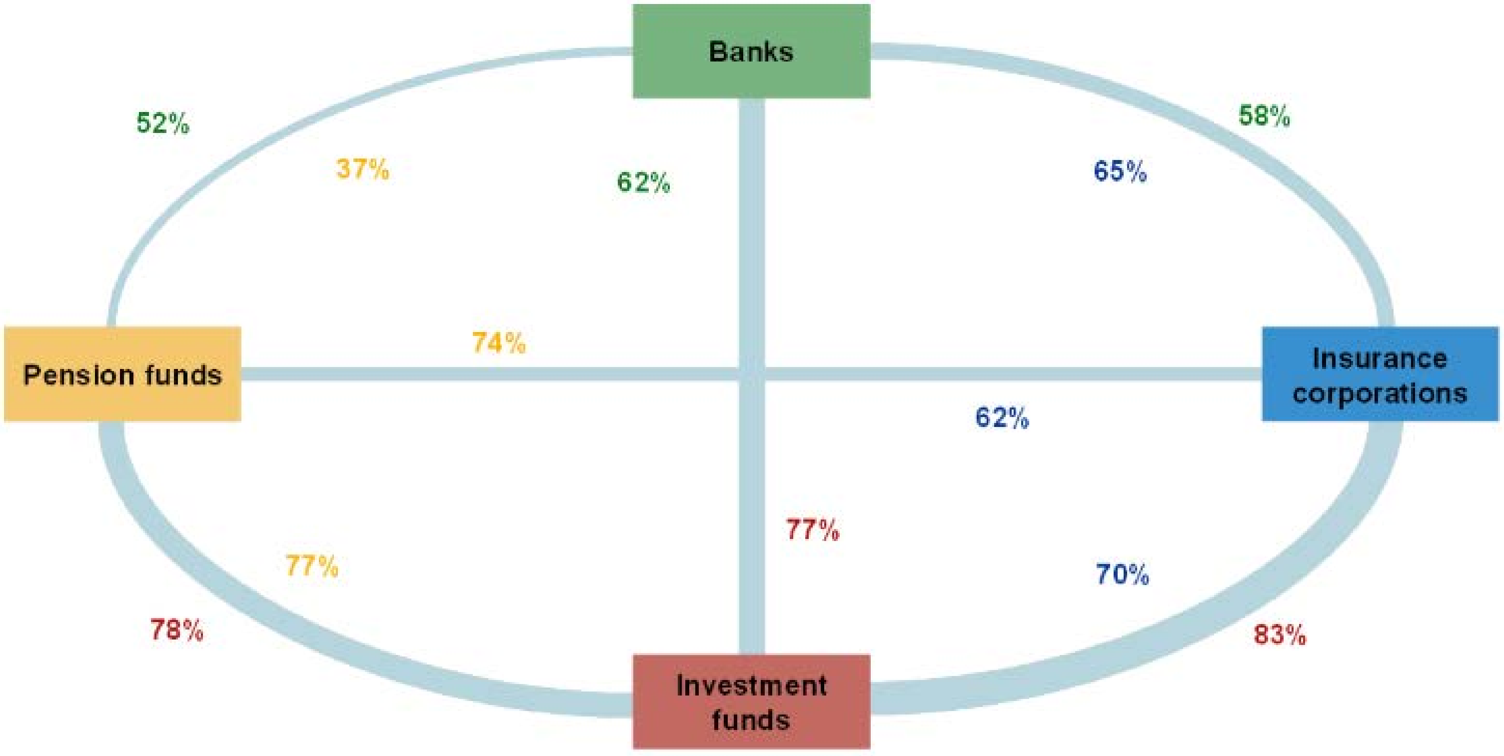
Leverage of investment funds and the flow-performance relationship
x-axis: lagged fund performance in percent; y-axis: net fund flows in percent of lagged total net assets



Source: ECB calculation/estimation based on Lipper for Investment Management Database (Thomson Reuters).

Common holdings create potential contagion channel between bank and non-bank sectors

Common securities holdings of euro area financial sectors
Q2 2018, percentage of the sector’s total securities holdings



Sources: ECB SHSS and ECB calculations.
Notes: Each node represents a financial sector. Green denotes banks, blue insurance corporations, red investment funds and orange pension funds. A link between a pair of nodes represents the sum of the common holdings of two euro area financial sectors (i.e. holdings of securities that are held by both sectors). Percentages denote the common holdings as a percentage of total holdings of the sector.

4. Designing a macroprudential framework

…the importance of having a macroprudential perspective

- Improve reporting and enhance monitoring
  - Broader and more granular data – particularly on OFIs
  - Consistent set of leverage metrics that captures risk
  - Standardised granular data infrastructure to map micro structure of financial system
- Enhance understanding of behaviour through macroprudential stress tests
  - Aim is to capture endogenous nature of systemic risk caused by interaction of institutions and markets in financial system instead of only ensuring resilience of individual entities
  - Mapping of system-wide key players
  - ECB internal work on system-wide stress testing framing key capital market interactions among different entities and sectors
- Macroprudential instruments for non-banks (ESRB, 2016)
  - Ex ante perspective to ensure resilient provision of financial services from the non-bank financial sector
  - Operationalise macroprudential leverage limits for AIFs (Article 25 AIFMD)
  - Operationalise existing liquidity tools for both AIFs and UCITS;
  - Consider additional macroprudential liquidity tools which are usable under stress

5. Conclusion

- Benefits of a well-functioning, diversified and integrated euro area capital market are clear
  - Provides for increased role in financing of the real economy – “spare tyre”
  - Enhances the shock absorption capacity of the EA economy
- But financial stability concerns also increase
  - The growing fund sector could harbour vulnerabilities from a system-wide perspective and for the financing of the economy more broadly
  - Need to monitor vulnerabilities, better understand contagion channels and behaviour
- As CMU is pursued, a broader and strengthened macroprudential framework beyond the banking sector is warranted
  - Developing macroprudential policies at system level will ensure that non-bank financing will be able to absorb shocks, rather than amplify exuberance and stresses